

**STATEMENT OF MITCH BAINWOL
CHAIRMAN AND CEO
RECORDING INDUSTRY ASSOCIATION OF AMERICA
BEFORE THE
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION
UNITED STATES SENATE
ON
MGM V. GROKSTER
JULY 28, 2005**

Mr. Chairman, Co-Chairman Inouye, I appreciate the opportunity to testify today on the Supreme Court's *Grokster* decision.

One month ago, the Court took a major step toward safeguarding and advancing one of this country's greatest resources—intellectual property. In a rare 9-0 decision, the Justices held unanimously in *Grokster* that those who encourage others to steal may be held liable themselves. The resulting message is straightforward and simple: theft, in any medium, is unacceptable.

Grokster is a peer-to-peer (“P2P”) file-sharing network that allows members to copy songs, movies, software, and other creative works over the Internet without paying for them. The result has been, in the words of the Supreme Court, “infringement on a gigantic scale.” These illicit networks have enabled the illegal copying of millions upon millions of *exact* duplicates of valuable works with the click of a mouse. Every day.

This massive theft has been particularly devastating for the music industry. In 1999, the domestic sale of music reached 14.5 billion dollars. By 2003, that figure had plummeted to 11.8 billion dollars. 2004 was virtually flat, and 2005 is down again, another 7%. Record companies are essentially venture capitalists, investing proceeds from the sale of recorded music back into new artists. It's a risky business, with only

about a 10% success rate. Yet, releases from the most popular artists (which make up most of that successful 10%) are often the ones most heavily pirated on illegal file-sharing networks. According to Soundscan, the top 10 albums sold 54.7 million units in 1999, compared to 37.4 million units in 2004. The top 100 albums sold 194.9 million units in 1999, compared to 153.3 million units in 2004. The result is less money to invest in new artists and new music.

A handful of studies have shown the direct correlation between illegal file-sharing and this decline in sales. David Blackburn of Harvard University found that “file sharing has had large, negative impacts on industry sales.”¹ Stanley Liebowitz of the University of Texas at Dallas concluded that, “there is strong evidence that the impact of file-sharing has been to bring significant harm to the recording industry.”² Other researchers have echoed similar findings.

Piracy sounds romantic, but not if you work in the music business. It’s a job killer. In addition to the decline in artist rosters, there have been thousands of layoffs of industry employees, and hundreds of shuttered music store doors. The effect of illegal file-sharing has been felt by songwriters, technicians, artists, and musicians, not to mention filmmakers, programmers, and scores of others who make their living from the creation and lawful sale of their products. The U.S. economy and the industries that employ over 5 million Americans have taken a massive hit from the billions of dollars lost annually through illegal file-sharing. Further, piracy on these networks is teaching an entire generation that stealing is acceptable.

¹ "On-line Piracy and Recorded Music Sales," David Blackburn (2004).

² "File Sharing: Creative Destruction or Just Plain Destruction?" Stanley Liebowitz (2005).

It's not. Unfortunately, standing against theft in the digital world has provoked some to label us anti-technology or against innovation. Such claims may make for good soundbites, but they are far from the truth. Technology is making the music experience better and better. From iTunes to ringtones, the music industry is continuously looking for new ways to get music to fans and is embracing new technology that allows for the widest lawful distribution of creative works.

The problem is with the behavior of bad actors who have used this amazing P2P technology to build businesses predicated on theft. They have reaped millions—and, indeed, stayed in business—by giving away our property and the property of thousands of others for free, receiving revenue from third party spyware and advertising aimed at those looking to steal. It has been estimated that over 90% of the file-sharing on Grokster and similar services is illegal copyright infringement. This is no accident. The more songs, movies, computer games, and other creative works that are stolen through their network, the more money these services make. As the Court noted, “the unlawful objective is unmistakable.” Without this illegal downloading, these services go broke. This is an unacceptable business model.

And that's precisely what the Grokster case was all about. The Court recognized that companies, like Grokster, that provide the tools and promote massive online infringement must be held responsible. As Senator Patrick Leahy observed, “This decision means that companies can no longer, with a wink and a nod, absolve themselves from any responsibility for what their products do. Just as consumers bear a responsibility for using these products to illegally download files, the companies that fashion and promote these tools must share in that obligation.”

The Court also noted the need for legitimate technological innovation and creativity, saying that their ruling “does nothing to compromise legitimate commerce or discourage innovation having a lawful purpose.” This is not about technology. The decision of the Court was technology-neutral, focusing instead on behavior and separating the good actors from the bad actors. It put the emphasis exactly where it should be—on those who “encourage infringement” while looking the other way as they reap the rewards.

The Court did not alter the standard established in its 1984 *Sony* case. In its own words, “nothing in *Sony* requires courts to ignore evidence of intent if there is such evidence, and the case was never meant to foreclose rules of fault-based liability derived from the common law.” Grokster and other bad actors can be held liable without threatening legitimate technological innovation or the *Sony* standard that has served creators and consumers so well.

Our position in this case was bolstered by incredibly wide-ranging support. The coalition against Grokster’s enabling of intellectual property theft includes the creative community, the law enforcement community, the family values community, and the technology community. During the *Sony* case in the 1980s, 20 Attorneys General from around the country were with the other side; this time, 40 were with us. The U.S. government filed on our side with a compelling brief by the Solicitor General. Key members of Congress, property rights groups, family groups, artists, technology companies, and others also filed in support of protecting property rights. There was enormous editorial support, from the *New York Times* and the *Wall Street Journal* to the

Washington Times and the *Washington Post*. Broad consensus, capped off with a unanimous Court decision.

Those who still claim that the law is not clear are few and far outside the mainstream. This is now a settled question. File-sharing copyrighted works without permission is illegal; encouraging it is also illegal. *Sony* is not a “get out of jail free” card. It will not protect you if you encourage theft. Grokster and similarly situated businesses that enable infringement need to realize that it’s time to go straight or face the consequences.

The turn of the new millennium, and the emergence of file-sharing, marked the first stage of P2P—an era of lawlessness where the excitement of a new medium and a lack of viable legal online alternatives paved the way for massive online theft. The second stage brought ambiguity, as education and enforcement of copyright by content owners was continuously thwarted by the misinformation and lure of free goods from Grokster and others. Now, with the decision of the Supreme Court, we have entered the third stage—and the bright future—of legal, responsible P2P file-sharing.

The legal and moral clarity provided by the *Grokster* decision is a shot of adrenaline for the legitimate marketplace. Capital will now naturally flow to technology companies that respect property and reward the future of music—companies such as iMesh, Snocap, Mashboxx, and Passalong, as well as Wurld Media, who is represented at this hearing today. In other words, the purpose of intellectual property protection as an investment lure is being met. Nascent technologies that operate within the law will have a chance to gain traction, attract investors, and appeal to fans. And we can increasingly sell, and thus invest, in new art, benefiting creators and consumers alike.

We are optimistic about the future. Two years ago, there was no legitimate digital marketplace to speak of. Today, we are watching the rapid emergence of quintessentially American competition for this new marketplace. iTunes, BuyMusic, Walmart, Sony Connect and others are battling it out for the download segment of the market. The result: in March 2005, 26 million songs were purchased from digital music stores in the United States.³ Yahoo!, Rhapsody, Napster, MSNMusic and others are battling it out for the subscription segment of the market. Many of the above and others offer both. Forty-three percent of music downloaders in 2005 have tried legitimate online music services⁴ and 34% of current music downloaders say they now use paid services.⁵ On college and university campuses across the country—hotbeds of illegal activity on exceedingly fast networks—administrations and students are embracing the legitimate offerings of these services and others.

More than 50 schools have entered into deals with companies like Ruckus Networks. Just last week, the University of California and California State networks signed with Cdigix, potentially providing hundreds of thousands of new students with the opportunity to legally obtain music and movies on campus. And, of course, the wireless market, already advanced elsewhere around the world, is poised to take off here as well.

But these legitimate businesses are able to thrive only by controlling the illicit services that directly compete with them. *Grokster* plays into this dynamic -- legally and culturally. Legally, those who don't play by the rules know that it is no longer acceptable to reap ill-gotten gains while burying their head in the sand. And, culturally, we've

³ NPD MusicWatch Digital Service.

⁴ Pew Internet and American Life study, March 2005.

⁵ Pew, March 2005.

pierced the nonsensical notion that somehow the taking of property is acceptable when it's music. All we want is a chance to compete, a chance for our investment to earn a return, and a chance to make great music for fans everywhere.

Thank you.